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Artículo

Ruled by “fear of floating”. Mexico’s exchange rate policy during the interwar period, 1925-1936

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ABSTRACT

This article argues that the Mexican exchange rate policy during the interwar years should be characterized as an archetypal case of “fear of floating”. Conventional accounts claim that Mexico escaped the Great Depression because its policymakers deliberately repealed the gold standard ideology. Drawing on new archival data, I argue that national policymakers remained conservative with respect to any regime change, and their preference was always for a fix or pegged exchange rate. Overall, this article claims that the monetary regime choice in Mexico was not driven by some new heterodox insights, and once the financial crisis of 1931 had forced a depreciation of the peso, the national monetary authority promptly rushed to join the dollar bloc.

Gobernado por el “miedo a flotar”. La política cambiaria de México durante el periodo de entreguerras, 1925-1936

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RESUMEN

Este artículo argumenta que la política cambiaria mexicana durante los años de entreguerras se puede caracterizar como un caso arquetípico de “miedo a flotar”. Los relatos convencionales afirman que México escapó de la Gran Depresión porque sus legisladores desecharon deliberadamente la ideología del patrón oro. Usando nuevas fuentes primarias, en este trabajo se sostiene que tanto los políticos nacionales como los integrantes del Banco de México fueron conservadores con respecto a cualquier cambio de régimen cambiario, prefiriendo un tipo de cambio fijo. En resumen, este artículo afirma que la elección del régimen monetario en México no fue impulsada por nuevas ideas heterodoxas. Con la crisis financiera de 1931, que obligó a una depreciación del peso, la autoridad monetaria nacional se apresuró a unirse al bloque del dólar.

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1. Introduction

In a speech given in May 2019, Agustín Carstens, general manager of the Bank for International Settlements (BIS) and former president of the Bank of Mexico (Banxico), underlined how the exchange rate policy theory and its implementation had always been a troublesome matter for policymakers of emerging countries. The supposed "benign neglect of the exchange rate" which, according to the common view, characterized emerging markets' central bank policy, was a "dictum honoured more in its breach than in its observance as a guide for monetary policy" (Carstens, 2019). The BIS general manager also underscored how the regime exchange choice must always be driven by praxis and institutional learning instead of theory. In fact, Carstens was adamant that, for emerging markets, history had shown that "the practice outruns the theory, and it is arguably the theory that needs to catch up" (id.).

Carstens' words confirm, once more, that exchange regime choice has always been one of the most controversial topics in the field of international economy studies. However, this does not imply that his argument sounds new to economic historians. Regarding the difference between *de jure* and *de facto* exchange rates, the literature on emerging markets has shown that since the 1970s, policymakers have tended to be reluctant to allow their exchange rate to float freely. This "fear of floating" problem, which mainly stems from a lack of credibility and the fear of losing access to the international capital market, was perennially a contentious argument for peripheral countries.[1]

The goal of this article is to show that the "fear of floating" mindset was not something new for Mexico; indeed, it was the main driving force behind the Mexican exchange rate regime choice during the interwar period. I will show that during the interwar years, such regime changes in Mexico were not driven by a radical change in policymakers' mindset from orthodoxy to heterodoxy. Although, the Mexican Central Bank (Banxico) renewed some of its previous goals and objectives after the Great Depression, the defence of a fixed exchange rate with the US dollar was always its main target. I follow this development primarily through the lens of Bank of Mexico officials, in order to show why Mexican policymakers of the time considered the fixed exchange rate the ideal regime to employ.

Historians have noticed that the years following the 1929 Great Depression represented a watershed in exchange rate regime history and a crucial moment for central banks. Indeed, there is an explicit consensus that during the 1930s, many countries changed their plans of action, jettisoning rigid exchange rate regime targets in favour of domestic macroeconomic goals (Eichengreen, 1992; Temin, 1989). However, as more recent contributions have shown, this choice was not as straightforward as it might appear. Economic historian Tobias Straumann (2010, 2012) illustrates how, after the 1929 crisis, some small European states maintained fixed exchange rate regimes even after the temporary suspension of gold convertibility. The devotion to fixed exchange rates, Straumann argues, was deeply rooted in a widespread consensus that small open economies needed fixed exchange rates because trade and investments would be hampered by the volatility of the float.[2]

Latin American countries in general have not yet received the same attention as European states.[3] Overall, scholars have also suggested that Latin American policymakers reacted to the Great Depression by letting their exchange rates float freely, in order to pursue domestic objectives. This change of regime is considered a crucial turn towards an inward-oriented development strategy.[4] The vast majority of existing literature on the Mexican experience supports this view, underlining how the regime change embraced at the beginning of the 1930s could be characterized as a sort of "Keynesianism before Keynes" (Zablaudovsky, 1980, p. 1). Scholars suggest that the reforms promoted by the former Minister of Finance Alberto J. Pani played a paramount role in this change. Indeed, according to this view, the change in Banxico's status, sponsored by Pani in 1932, allowed the central bank to finally pursue an aggressive monetary expansion.[5]

As I will show in the following pages, from 1926 to 1936 Mexican exchange rate policy resembled the experience of small European countries as described by Straumann. I argue that also in Mexico, the Great Depression did not change policymakers' mindset, and the commitment to fixed exchange rates always guided the actions of politicians as well as the central bank's officials. Monetary and banking reforms during those years were not dictated by a new master plan, but rather resulted from a series of improvisations dictated by circumstances.[6] Banxico's reforms, which followed the currency and banking crisis of 1931, allowed the government to regain a modicum of monetary autonomy. Nevertheless, policymakers were reluctant to increase the money supply and always prioritized the defence of the fixed exchange rate. Indeed, when the dollar bloc was formally established, government officials and Mexican central bankers rushed to join it. Various reasons, related primarily to some previous episodes of Mexican history, made this choice coherent. Devaluation evoked memories of the hyperinflation that had characterized the last year of the Mexican revolution (1915-1917) and hindered the diffusion of paper money. Furthermore, a reduction in the peso's value undermined investors' confidence as well as access to foreign capital, which was desperately needed in order to rebuild the

[1] For an analysis of literature on the post-1970s fear of floating, see Calvo and Reinhart (2002). Economic historians have shown that the "fear of floating" problem seems to have been prevalent also during the pre-1914 years. See Bordo and Flandreau (2003).

[2] Straumann's study focuses on the experience of Austria, Belgium, Denmark, the Netherlands, Norway, Sweden and Switzerland.

[3] See Díaz Fuentes and Marichal (1999) for a comparative study of the origins of central banking in Latin America

[4] For a general view, see Campa (1990) and Jacome (2015). Recent studies based on the cases of Argentina and Chile seem to confirm Campa's hypothesis. For Argentina, see della Paolera and Taylor (2003), and for Chile, see Uziel González (2021).

[5] The idea that Pani's actions were driven by some form of "nstinctive Keynesianism" is supported by Cárdenas (1987), Gómez Galvarriato (2002), Turrent Díaz (2015), Suarez Dávila (2018), and Moreno Brid and Ros (2009). Contradicting these views, Maria Eugenia Romero Sotelo (2012) suggests that the Mexican economy switched from orthodoxy to heterodoxy during the presidency of Lazaro Cardenas (1934-1940).

[6] This interpretation echoed and expanded the economic historian Carlos Diaz-Alejandro's accounts of the interwar period. According to Alejandro, the behaviours of some Latin American policymakers during the Great Depression's turmoil were not dictated by theories extrapolated from "the writings of economists, either defunct or alive"; rather, they were practical solutions that followed "survival instincts". See Carlos Diaz-Alejandro (1980, p. 19).

country after its revolutionary years. In short, the "fear of floating" ideology was nurtured among the central bank's officials and policymakers, with the idea that a fluctuating exchange rate would encourage speculation and thwart the monetary policy and control of inflation.

The article is structured as follows. The next section presents a critical review of the literature on the Mexican monetary experiences during the interwar period. Here, I propose a new classification method which helps to provide an overview of the exchange rate policy of the time. Using a qualitative historical approach, the main corpus of the article identifies the principal turning points in exchange rate management during the period under analysis. In particular, I focus on the problems experienced by Mexico on the eve of the Great Depression, in relation to maintaining the gold standard (Section II). The following section examines the reaction to the 1929 crisis and the institutional changes that strengthened the power of the central bank (Section III). Lastly, I investigate the changes in national and international circumstances which led Mexico to join the dollar bloc (Section IV).

2. Mexico's interwar exchange rate regime: an overview

Today, as well as during the interwar period, exchange rate regimes can be classified as either *de jure* or *de facto*. The *de jure* (legal) type is a regime that countries declare is running, whilst the *de facto* classification is based on the premise that for various reasons, countries adopt different policies in practice. The Mexican exchange rate regime during the interwar period represents an example of conflict between these two classifications. As Figure 1 shows, throughout the period under scrutiny, the *de jure* exchange rate never changed. Nevertheless, by following the *de facto* exchange rate it is possible to identify three different exchange rate regimes. The first phase, where the peso–dollar exchange rate fluctuated closely but irregularly around the gold points (1918-1931), was followed by a deep depreciation and an irregular floating period until the end of 1933, when a new fixed exchange rate with the dollar was established, at 27.78 US$ cents to the peso.

The main reason for the extreme discrepancy between *de jure* and *de facto* exchange rates during the interwar period was the monetary, financial and political chaos which followed the Mexican Revolution (Haber *et al*., 2003). As proof of the difficulty of defining the exchange policy implemented by Mexico during the 1920s, even if there is a general agreement about the fact that Mexico abandoned the gold standard during the 1930s, the descriptions of the exchange rate regime which preceded this moment are contradictory.[7] According to the monetary law of the time, Mexico adopted the gold standard in November of 1918. This law stated that the Mexican peso was equivalent to 75 centigrams of gold, a weight which guaranteed a fixed type of exchange with the US$ at 0.4985. This *de jure* classification lasted until the end of August 1936, when a decree approved by President Lazaro Cardenas erased the adherence to gold parity.[8] Nevertheless, hyperinflation and the disintegration of the pre-revolutionary banks of issue during the 1913-1917 period gave birth to a monetary system in which the only currency circulating among the public was gold coins. The latter were supported by fractional silver coins with a bullion value below the gold par. In fact, not even the establishment of a central bank in 1925 could change the monetary landscape. Although Bank of Mexico paper money was covered by a gold reserve, the government's efforts to induce people to use banknotes were unsuccessful.[9] The heavy coinage of silver pesos further undermined the *de jure* gold standard. This action was carried out by the government from 1921, with the main goal of covering the national budget deficit by using seigniorage profits.

Throughout the 1920s, the nature of Mexico's exchange rate problem was shaped by the fact that although its currency was nominally denominated in gold, the great bulk of the money supply was made up of silver, which was traded at a discount to its *de jure* monetary value.[10] Figure 1 shows that aside from two short periods between 1918 and 1921, and the end of 1925, the gold peso remained below the gold export points during the entire post-revolutionary period. Scholarly interpretations regarding the 1930s seem more straightforward. Mexico, like other Latin American countries, was unable to maintain its currency at par after the Great Depression. Yet, according to the existing literature, a new exchange rate regime change was enacted in 1932 when the country deliberately let the exchange rate float freely, in order to focus monetary policy on domestic objectives.

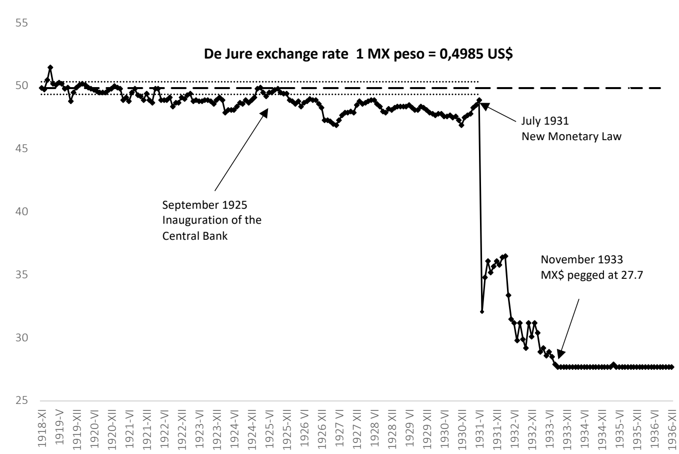

Figure 1. De Jure and De Facto exchange rate between MX$ and US$, 1918-1936 (dashed line: gold parity; dotted lines: upper and lower gold points).

Sources: Boletin Minero y Financiero (1918–1925) and Banxico, *Informes Annuales* (1925-1936).

[7] For example, Edwin Kemmerer (1940, p. 135) recounted that Mexico adopted and maintained the gold standard "with slight interruption" from 1918 until the summer of 1931. Barry Eichengreen, (1992, pp. 188-190) suggested that Mexico adopted the Gold Standard in 1925, when the Central Bank of Mexico was set up. Lastly, Daniel Díaz Fuentes (1994, p. 180) stated that the gold standard adoption might be dated to 1927.

[8] Diario Oficial de los Estados Unidos Mexicanos (hereafter DO), 31 Aug 1936.

[9] The main reason was the complete lack of public confidence in paper money: the memory of revolutionary hyperinflation was still very vivid in Mexican society during the 1920s. See Sterrett and Davis (1928).

[10] For a description of the Mexican monetary system during the 1920s, see id.; Nodari (2019).

Table 1

Classification of Mexican exchange rate regimes, 1925-1936

	Modern benchmarks (2001-2006)		*Interwar values (1919-1939)*			*Mexican observations (1925-1936)*		
	Freely Floating	**Hard Pegs**	**Free Floating (Pre-1927)**	**Gold Standard (1927-1931)**	**Managed Floating (from 1931)**	**9/1925-25/7/1931**	**26/7/1931-10/1933**	**11/1933-1/1936**
Lamda Kurtosis Index	0.58-0.68	0.1-0.15	0.49	0.11	0.17	**0.19**	**0.22**	**0.10**
Lamda Reserves Index	0.58-0.68	0.09-0.24	0.19-6.18	0.04-0.12	0.10-0.28	**0.06**	**0.57**	**0.05**

Sources: Data for weekly type of exchange between MX$ and US$ are taken from *Boletín Minero y Financiero* (1925-1932) and *Excelsior* (1932-1936). The central bank's gold reserve data came from Banxico, *Informe Annual*, various issues, and Board of Governors of the Federal Reserve System, *Banking and Monetary Statistics, 1914-1941*, 1943, pp. 544-557. Modern benchmarks (2002-2006) and interwar (1919-1939) values are taken from Urban, *The Name of the Rose* (p. 32).*

* Scott Urban's panel consists of 48 currencies: Algeria, Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, China, Colombia, Cuba, Czechoslovakia, Denmark, Egypt, Estonia, Finland, France, Germany, Greece, Hong Kong, Hungary, India, Indonesia, Ireland, Italy, Japan, Latvia, Mexico, the Netherlands, New Zealand, Nigeria, Norway, the Philippines, Poland, Portugal, Romania, Russia, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, the United States, Venezuela, Yugoslavia. See Urban (2009, pp. 17-19).

However, these interpretations call for careful scrutiny. Some scholarly positions indeed offer little evidence of assessing the exchange rate regime choice using empirical and historical analysis. Indeed, the vast majority of existing literature in Mexico uses as a main source the memoirs of Alberto J. Pani, Secretary of the Treasury from 1931 to 1933. Pani, in his well-known pamphlet of 1935, describes his action as "revolutionary", driven by the main desire of tackling deflation at any cost (Pani, 1935). Furthermore, these works automatically associate an exchange regime outcome with an exchange regime-type choice, without considering that the original goal of policymakers might have been difficult to implement in practice. In order to avoid these biases and empirically categorize the variations in the exchange rate regimes throughout the period, the classification methodology proposed by Scott Urban (2009) has been used. This model considers two observable statistics: the variation of the exchange rate itself *(Lamda Kurtosis Index)* and central banks' international reserve *(Lamda Reserve Index)*.

The rationale for adopting Urban's model is twofold. Together, these two statistics allow us to differentiate between how exchange rates effectively moved (regime outcome) with respect to what the monetary authority was trying to do (regime intention).[11] Moreover, it allows us to compare Mexico's effective monetary regime features with both the modern and interwar exchange rate regime classifications that are typically found in the literature.

[11] Urban uses a kurtosis-based index, in which kurtosis of the first derivative of the exchange rate with respect to time is used to scale the coefficient of variation of the exchange rate in levels. The lambda kurtosis index is the coefficient of variation of exchange rate divided by the kurtosis of the first derivative of exchange rate. A floating exchange rate regime is presumed to be associated with a higher degree of exchange rate variation vis-à-vis a fixed exchange rate. The lambda reserve index is the square root of the coefficient of variation of the exchange rate divided by the coefficient of variation of reserves. Following a balance of payments identity, the lambda reserve index is used as an indication of regime intention. For details see Urban (2009, pp. 14-31).

To build the model, I drew on weekly exchange rate data from official sources at the central bank, as well as financial newspapers' articles. However, international reserve data suffers from several pitfalls. First, the data are generally tracked monthly and not weekly. Furthermore, the central bank reserve was subject to considerable misreporting and obfuscations. Whereas the data usually tracked silver, gold, and the foreign exchange reserve for the period of 1925 to 1931, from that year until the end 1933 only gold and silver data are reported. Moreover, after December 1933, Banxico's official data only report gross international reserves, without specifying their composition. Apparently, this was a deliberate decision taken by the bank's board of directors to avoid speculation and criticism of its monetary policy management.[12] To overcome this data inconsistency, I retrieved figures on the percentage of gold in Banxico's total gross reserve from the US Federal Reserve Board's monthly reports. Since it is impossible to estimate the quantity of foreign exchange stored in the central bank reserve, the Lambda Reserve Index only considers gold reserves.

Table 1 offers an overview of the Mexican exchange rate system classification for the years 1925 to 1936. The results suggest that the Mexican exchange rate regime in place from 1933 to 1936 constituted a hard peg, while the reserve index indicates a situation close to the interwar gold standard classification. Also, for 1931-1933 the interpretation appears straightforward: the reserve index suggests a floating exchange regime, while the kurtosis index value is exactly halfway between a hard peg and a freely floating regime, according to both modern benchmarks and interwar benchmarks. In contrast, the years between 1925 and 1931 are more difficult to characterize. According to gold reserve variations, the regime should be described as similar to a gold standard; yet the exchange rate value suggests a situation similar to a "managed floating".

[12] Banxico's Board debated this issue several times. See, for example, Acta 498, 15 Jan 1934, and Acta N. 561, 20 Feb 1935, Archivo Historico Banco de Mexico (hereafter AHBM).

Whilst this description offers a starting point for the interpretation of the Mexican choices, numerous questions remain unanswered, assuming that the *de jure* classification did not match with the *de facto* situation. First, how can we characterize the exchange rate regime of the late 1920s? Although the reserve index indicates that Banxico's officials intended to defend a gold standard regime, the outcome was different. Moreover, the fact that the period of free floating was followed by a quick adoption of a hard peg regime calls for further reflection. We might therefore ask whether the 1931 change resulted from a new mentality, or from the practical impossibility of defending the peg. And if the regime change was caused by a new mentality, then why subsequently return to a new version of the old golden fetter, after enjoying the freedom of domestic policy independence? To answer to these questions, in the following pages I will scrutinize in detail the historical conditions under which policymakers made their decisions, their ideas about what exchange rate system was best for the country, and the factual problems they faced in pursuing their goal.

3. When leaning against the wind was impossible: the 1925-1931 years

As described in the previous section, the Mexican monetary system was unstable, and the heavy coinage of silver had fundamentally altered the gold standard law of 1918. In addition, the lack of a central monetary authority jeopardized solving the problem of exchange rate management. Due to these conditions, the establishment of the central bank in 1925 created substantial expectations from both the public and policymakers. According to Secretary of the Treasury Alberto J. Pani, the new central bank's control over monetary and financial stability would have helped to eventually stabilize the gold standard, thus beginning "a new era of prosperity for Mexico".[13] These high expectations were at least in part justified. The possibility of issuing paper money, and thus defending the fixed exchange rate through the bank's reserve, had the potential to solve some of the existing problems. By the end of 1925, Banxico's international reserves were roughly MX$ 50 million: 32 in gold, 14 in silver, and the rest in US dollars. Although this reserve was not huge, it was considered sufficient to intervene in the market to temporarily correct exchange rate misalignments.

For policymakers as well as for Banxico's officials, the defence of exchange rate parity was a priority. Manuel Gómez Morín, head of Banxico's board of directors, summed up the reasons for this preference in a long memorandum, discussed with his colleagues in August 1926. Some of his opinions resemble today's policymakers' problems. Indeed, the rise in the real burden of the gold-denominated debt service and the capital flight, which usually follows every depreciation, deeply concerned the policymakers. Nevertheless, Gómez Morín's biggest concern was instead the consequences of depreciation on the internal money supply. Whenever the peso lost value with respect to the dollar, large sums of gold coins left the country. Since gold was flowing out of Mexico, it became scarce within domestic circulation, which in turn decreased the value of silver currency linked to the gold, and fostered every kind of speculation. Therefore, supporting the peso at official parity with the dollar was a matter of "vital importance" for the country's economic future.[14]

Notwithstanding their priorities, policymakers had to face the reality. The classic tools used by central banks to defend gold standard pegs did not yet exist in Mexico. Thus, to actively control foreign exchange markets, Banxico had to centralize gold and foreign exchange in its vault, but this posed a fundamental problem for the bank. Indeed, during the 1920s, most European and also Latin American countries adopted the gold exchange standard. Under this system, gold coins were to be withdrawn from circulation, as only central banks were allowed to store gold in their coffers.[15] In Mexico, because a few powerful private banks who feared competition from the central bank controlled the country's foreign exchange markets, Banxico's efforts to collect forex to build up its reserve faced strong resistance.

Contemporaries were aware of these problems. A confidential pamphlet written by Gómez Morín in 1930, which was also privately discussed among the central bank's board, illustrates the reasons for the exchange rate management problems. As Morín observed, "we are facing the impossibility of effectively applying even the elementary means recommended by the theory to remedy an exchange crisis"[16]. According to him, the cause of this setback lay in the institutional design of the central bank, its international isolation, and in the inefficient monetary system which fuelled a dispersion of national gold.

Institutionally, Banxico had been designed as a bank for banks, but the central bank lacked the basic monetary policy instruments to promote any exchange rate arrangements. Moreover, it was faced with the financial backwardness of the country, and the lack of an integrated banking system. Banxico was therefore working in a "financial desert", where all the private banks acted autonomously, and in some cases deliberately, against the central bank's attempt at monetary stabilization.[17] Daily fluctuations between gold and silver encouraged speculation, by the general public as well as by private banks.

The lack of instruments to control money supply, combined with the bank's international isolation, obliged the bank to rely exclusively on its gold reserves. This led to another issue. In Mexico, the great bulk of gold was "not even concentrated in the hands of the Government or in the central bank institution, but disseminated among the public and commercial banks".[18] Due to this dispersion, the majority of gold coined by the national mint could not be managed or controlled by the central bank. As a consequence, when an exchange crisis hit, central bankers had to wait for a "fundamental improvement of the economic question or in a temporary favourable modification of the balance of payments" –including in cases "when by nature it should be transitory and its effects can easily be avoided".[19] Based on this premise, the central bank's reserves could only be used as a remedy for a transitory crisis; until at

[13] "Finance Chief tells hope on pact: Pani tells of hope of pact", *Los Angeles Times*, 22 Sep 1925.

[14] "Situación de los cambios", 23 Aug 1926, Archivo Manuel Gómez Morín (hereafter AMGM).

[15] For a general description of the gold exchange standard in interwar Europe, see Accominotti (2019).

[16] Manuel Gómez Morín, "Situación de los cambios", 1930, AMGM, Box 41.

[17] Manuel Gómez Morín, "Memorandum: Sucursales de Bancos Extranjeros", 3 Dec 1926, AMGM, Box 41.

[18] Manuel Gómez Morín, "Situación de los cambios", 1930, AMGM, Box 41.

[19] Id.

Table 2

Central Bank and private banks' reserves, 1926-1931

Years	Gold (MX$m)				Silver (MX$m)				*Foreign Exchange*	
	Coinage[a]	*Central Bank reserve*[b]	*Private banks' reserves*[c]	*Circulation*[d]	*Coinage*[a]	*Central Bank reserve*[b]	*Private banks' reserves*[c]	*Circulation*[d]	*Central Bank reserve*	*Private banks' reserves*
1926-I	309.9	32.7	-	-	215.5	28.5	-	-	5.7	18.9
1926-II	324.9	9.2	-	-	236.8	10.5	-	-	13.9	17.5
1927- I	340.2	18.2	-	-	239.3	10	-	-	6.6	16.9
1927-II	355.2	11.8	-	-	242.4	4.9	-	-	10.5	26.7
1928-I	369.1	15.8	-	-	243.6	9.4	-	-	9.1	35.7
1928-II	382.1	12.5	-	100	243.6	8.6	-	205	8.1	34.7
1929-I	393.5	8.5	29.8	-	243.6	13.5	19.6	-	16.1	33.5
1929-II	405	14.5	30.2	95	243.6	13.3	20.2	205	19.6	35.6
1930-I	414.2	12.6	26.6	-	244	24.1	21.3	-	14.7	24.8
1930-II	423.6	8.9	27.1	90	244	10.8	36.3	195	3.6	15.5
1931-I	430.4	7.9	19.7	20	244	7.6	35.7	195	0.5	23.7

Sources: a = Total coinage from 1917, see Secretaria de Hacienda y Crédito Público (SHyCP), *Memorias de la Casa Moneda de México*, various issues; b = AHMB, *Informe Annual*, various issues; c = SHyCP, *Boletín Estadistico de la Comisión Nacional Bancaria*, various issues; d = Estimation made by Mexican central bankers, see AGM, Caja 590, Exp. 2004.

least the central bank might be able to control and dispose of a substantial gold and foreign currencies fund. In the case of a longer and deeper crisis, the "artificial intervention in the exchange market would generally be followed with serious losses and with very little public benefit".[20]

Table 2 summarizes the situation described by Manuel Gómez Morín. From 1917 to 1930, the total amount of gold coined in the country was around MX$ 423 million. While the central bank stored MX$ 8.9 m of gold in its reserves, commercial banks held MX$ 27.1 m –more than three times the amount controlled by Banxico. Regarding the possibility of estimating the exact amount of gold circulating among the public, the approximations made by central bankers show a deceptive picture. Only MX$ 90 million were in the hands of the public, while the great bulk of gold coined during the 1920s either left the country illegally or was hoarded by the public.[21]

The fall in primary commodity prices, which started in 1928 and accelerated dramatically in 1929, as well as the protectionist policies developed by industrial countries, caused a deterioration in Mexico's balance of payments and fostered a huge outflow of gold from the central bank's reserve (Bulmer Thomas, 2003; Kuntz, 2010). In only one year, from March 1930 to March 1931, the gold and forex reserve of the bank dropped by 85 %, from MX$ 20.8 m to MX$ 3 m. The fall in the exchange rate caused not only a heavy flight of gold –and, consequently, increased the premium of gold pesos against silver pesos– but it also triggered a huge flight of capital outside the country.[22] Faced with a storm, Banxico sought emergency solutions. At the end of October 1930, instead of allowing the peso to depreciate, the board of the central bank met the Ministry of Trade officials and chief executives of the most important commercial banks. They devised a plan to protect the gold reserves, through a strict rationing of luxury goods imports, a control on capital exports, and a strict regulation on the sale of the rare dollars available in the market.[23] To enhance these exchange controls, the board of Banxico established an Exchange Regulating Commission (ERC) on 24 December 1930. The Commission had the task of supervising imports, and managing the distribution of the country's scarce foreign exchange reserves. Thanks to a six-month loan of US$ 15 m (roughly MX$ 30 m) offered by the National City Bank, the plan was to hold up the value of the peso and monopolize the foreign exchange control by selling dollars in the Mexican market in exchange for gold and silver, at a price decided daily by the ERC's board.[24]

As Figure 2 shows, after dropping to US$ 46.9 cents in December 1930, the exchange rate saw an improvement at the beginning of 1931, thanks to the Commission's work. However, this exchange support could not last forever. The plan to defend the value of the peso broke down in March 1931 when ERC's reserves were exhausted due to increasing demand for dollars.[25] In May 1931, the central bank established a syndicate with the most important private banks of Mexico. Under Banxico's control, all the associated banks agreed to only sell foreign exchange at a pre-defined price, in exchange for gold and silver. According to a member of Banxico's board of directors, Luciano Wiechers, this exchange control mechanism constituted an attempt made "by the central bank to monopolize the market of foreign exchange", curbing the "unscrupulous actions" of speculators and preventing further depreciation of the national money.[26] The syndicate threatened to imprison anyone trying to deal at rates other than those fixed by bankers.

[20] Id.

[21] Id.

[22] The central bank's board of directors estimated that, since the middle of 1930 until October of the same year, at least three million in gold peso per month were smuggled out of the country. See Acta N. 289, 3 Oct 1930, AHBM.

[23] "La garantia de los depositos plata", *El Universal*, 29 Oct 1930.

[24] See Acta N. 320, 27 Jan 1931, AHBM, and "City banks lend $ 15,000,000 to Mexico", *Wall Street Journal*, 1 Jan 1931.

[25] Acta N. 337, 24 Mar 1931, AHBM. According to the President of Banxico, Alberto Mascareñas, the dollars were already exhausted in April 1931. See "Memorandum. Junta Central Bancaria", 31 May 1931, Archivo del Banco de Mexico, Fondo Alberto Mascarenas (hereafter AM), Box 20, File 3.

[26] Acta N. 349, 19 May 1931, AHBM.

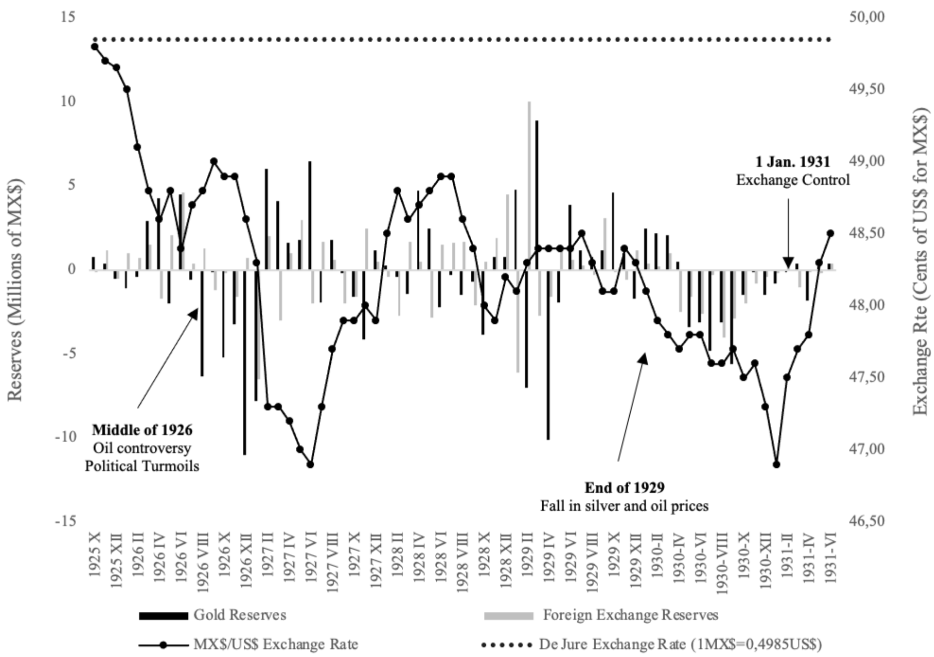

Figure 2. Monthly exchange rate fluctuations and Banxico's reserves variations (1925-1931).

Sources: Exchange rates between MX$ and US$ are taken from *Boletín Minero y Financiero*, the central bank's gold reserve data came from Banxico, *Informe Annual*, various issues.

However, the exchange rate fluctuation and the discount between gold and silver pesos offered a stimulus to a variety of illegal operations.[27] Unable to meet the demands made upon them, by the beginning of June, the syndicate withdrew their support for the arrangement, thus destabilizing the exchange situation in Mexico. According to some contemporaries, the money market in Mexico City was completely out of control. The crisis reached a point where speculators with as little as fifty thousand US dollars could "at any time run the exchange rate up or down […] as much as ten points in a single day" (Sympson, 1932, p. 76).

It was clear to everyone that the monetary system implemented in 1918 had collapsed. The gold reserve's exhaustion, the growth of the premium between gold and silver currency, and the sharp drop in the exchange rate, were problems that the Secretary of Finance, Luis Montes de Oca, considered as "increasingly pressing and urgent", and were to be treated with "non-renewable character".[28]

4. Everything must change for everything to remain the same: the 1931-1933 years

On 25 July 1931, the Mexican Congress approved a law which altered the currency system. Known as the "Calles Law", in honour of former Mexican President Plutarco Elias Calles, the new monetary law caused some distrust and misunderstanding among contemporaries, and even between some scholars. Such misconceptions are attributable to the confused text, but also to the monetary turmoil faced by the country in the second half of 1931 (Turrent Díaz, 2015).

The goal of the law was, as the Secretary of the Treasury Luis Montes de Oca claimed, to "comply with the fundamental principle" of any sound monetary system –namely, "preservation of the gold standard".[29] Mexican policymakers aimed at moving from a gold coin standard to a gold exchange standard, as European countries had during the 1920s.[30] To reach this goal, the law attempted to correct what policymakers considered the main issue of the old monetary system: the dispersion of gold amongst the public. To that purpose, the law demonetized gold coins, made banknotes freely convertible into gold, and removed restrictions on gold exports. Since no paper money whatsoever was in circulation in Mexico when the law was passed in July 1931, it also made silver coin legal tender as a temporary measure.[31]

It is important to underline the fact that Mexican officials did not choose to devalue the peso. During the law's preparation, the policymakers debated three alternatives for the new exchange rate target: devaluation, overvaluation, and finally, maintaining the current exchange rate. The hypotheses of devaluing at "60, 50, or 40 centigrams of gold per peso", or alternatively, "choosing a type of exchange above the current conversion", were discarded, as they would both have failed to guarantee a stable exchange rate in the short term.[32] By elimination, financial authorities were then left only with the possibility of keeping the exchange rate at 75 centigrams of gold per peso, thus "making the effort required to ensure stability".[33]

However, a series of setbacks complicated the plan. Lack of confidence in national policymakers, and mistaken ideas about the content of the law, fostered a huge flight of capital and

[27] Manuel Gómez Morín, "Bancos y Capitales", 1931, AGM, Box 1, Exp. 13.

[28] "Montes de Oca to Banxico's Board", 23 Jul 1931, Archivo Luis Montes de Oca, Legajo 1/137, C. 227 de 493.

[29] Congreso de los Estados Unidos Mexicanos, *Exposición de Motivos*, 25 Jul 1931.

[30] The economist Robert Triffin (1968, p. 42) estimates that the withdrawal of gold coin from circulation accounted for 44 per cent of the growth of European central banks' gold reserves between 1914 and 1928.

[31] DO, "Ley monetaria de los Estados Unidos Mexicanos", 27 Jul 1931.

[32] Manuel Gómez Morín, "Memorandum. Type of exchange", 1931, AGM, Box 41, File 85

[33] Ibid.

triggered a twin crisis, which saw a run on the peso accompanied by distress among some private banks.[34] In the week following the law's approval, the peso suffered a precipitous fall. Within days it was trading roughly at half of its par value, and expectation of a further depreciation led to overshooting (see Figure 1).[35] The failure of the monetary law pushed Luis Montes de Oca to resign; he was replaced by the previous Secretary of Treasury, Alberto J. Pani. As described in the first part of this paper, it is generally agreed among historians that, with his master plan of "fighting the deflation without falling into inflation", the new Secretary of the Treasury chose monetary policy independence over a fixed exchange rate, letting the peso float in order to focus all attention on fighting deflationary pressures. Yet this description seems to misjudge the goals of Pani's plan. It is true that his action partially eased the deflationary spiral which followed Calles Law's approval. Indeed, from the second semester of 1932, the number of banknotes in circulation grew steadily. These banknotes were issued primarily against rediscounted bills, given that during 1932 and 1933 the government imposed draconian rules against the private banks, and obliged them to associate with the central bank (Sympson, 1932. Furthermore, the public started to accept the paper notes in daily transactions, thus alleviating the monetary stringency caused by deflation and signalling the public's growing trust in Banxico.[36] Whereas in the second semester of 1931, all the gold previously hoarded was exported, silver coins kept growing steadily until the second semester of 1932, when a presidential decree authorized the Secretary of the Treasury to order an "extraordinary coinage of silver peso only for one time".[37]

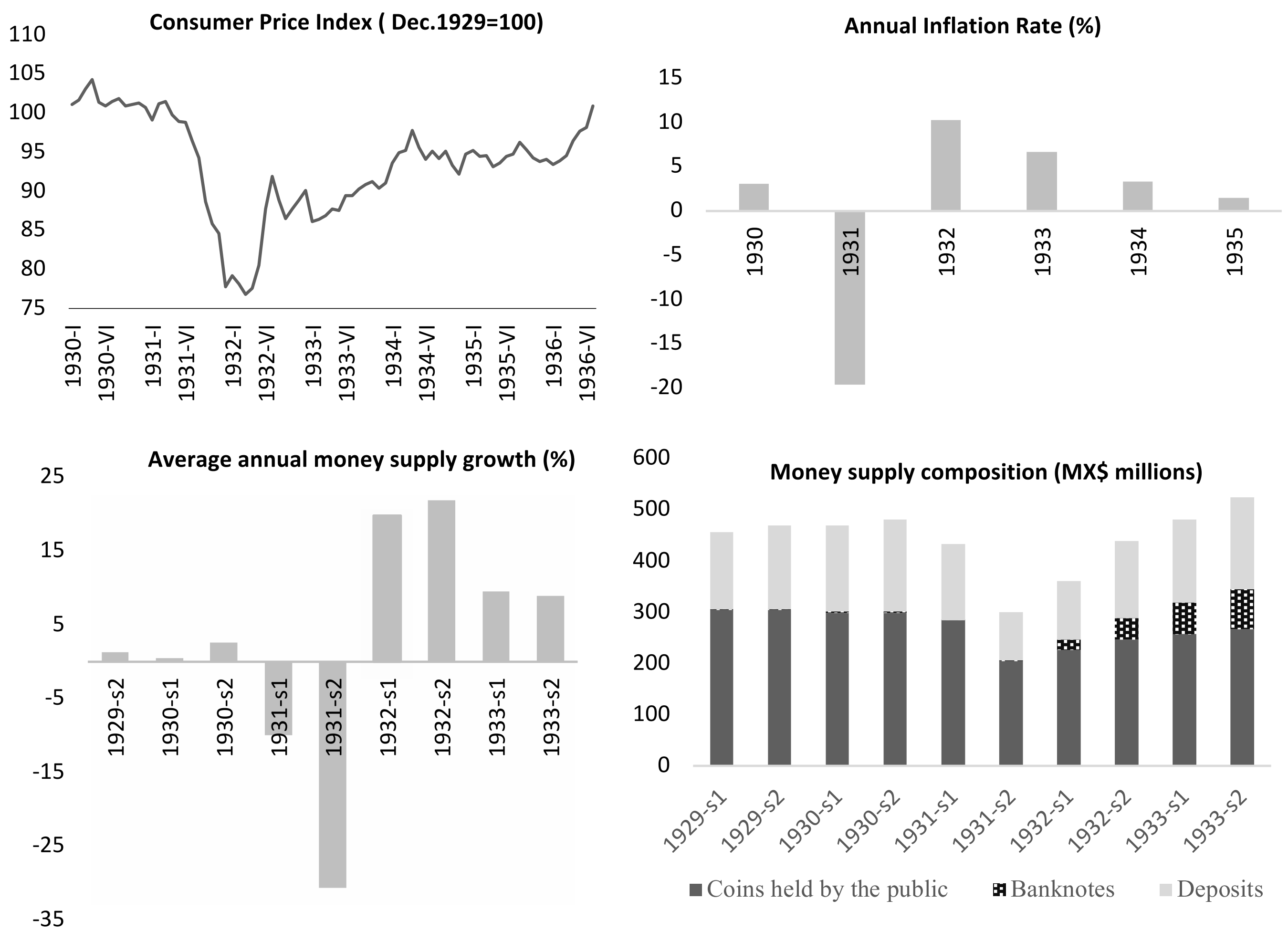

Figure 3. Expansion or tightening? Reaction to the 1931 crisis.

Sources: For the Consumer Price Index, see Secretaría de la Economía Nacional, *Revista de Economia y Estadistica*, various issues; and AHMB, *Informe Annual*, various issues. Money supply growth and composition are the author's own calculations based on SHyCP, *Boletín Estadistico de la Comisión Nacional Bancaria*, various issues; and AGM, Caja 590, Exp. 2004.

[34] An analytic study of the 1931 crisis goes beyond the aim of this article. Mexico experienced a currency crisis, since the peso suffered a depreciation of 39% versus the dollar in just one week. Nevertheless, only two banks failed during 1931's financial turmoil, while the others survived the pressures.

[35] Banxico launched a campaign to support the monetary law, and calmed the public. See "La emisiòn de billetes", *El Universal*, 5 Nov 1931.

[36] Manuel Gómez Morín, "Memorándum Número 3. Strictly Confidential", 12 Mar 1932, AGM Box 41, File. 88.

[37] DO, N.9, 10 Mar 1932.

Table 3
The Bank of Mexico's new legislation, 1931-1933

	Monetary Law, 25 July 1931
Legal cover	Banknotes backing in gold (50%) or silver (100%)
Bankers' bank	Rediscount with associated and non-associated banks
Exchange rate and reserve	Fixed at the pre-crisis parity New centralized gold reserve in order to defend the exchange rate
	Decree, 10 March 1932
Exchange rate and reserve	Only Banxico's Board of Directors are in control of the reserve
	Banking Law, 12 April 1932
Bankers' bank	New rules on rediscount policy
	Decree, 12 September 1932
Exchange rate and reserve	All classes of foreign currencies, except gold, were denied to entry into Mexico
	Decree, 24 September 1932
Exchange rate and reserve	The decree prohibited the export of gold minted within the Republic and provided that such gold must be purchased by the Treasury at the prevailing market rate
	Decree, 5 September 1932
Bankers' bank	All banks (national and foreign) receiving deposits from the public must be associated with Banxico
	Decree, 22 March 1933
Exchange rate and reserve	Preference must be given to Banxico in the case of equality of prices, over any other purchaser in the sale of foreign currencies. Whenever Banxico so requires, the other banks must declare their positions with regard to forex, and transfer to Banxico, if it so desires, any amount of draft, investment or deposits in foreign currencies.

Source: Diario Oficial de los Estados Unidos Mexicanos (hereafter DO), various issues.

These reforms, as Figure 3 shows, fostered a moderate monetary expansion. Nevertheless, ever since arriving in office, Pani had made no secret of his preference for a return to a fixed exchange rate. Thus, in the middle of 1932, he declared that "once the general economic condition [improved]" it would be possible to defend the "old legal parity of the peso" (Pani 1950, p. 143). The problem, however, was that Banxico did not have sufficient reserves at its disposal to defend the old parity. The gold reserve had shrunk dramatically since the second half of 1930, and by the end of July 1931 its official reserves were practically exhausted.[38]

It was this lack of reserves that eventually forced Banxico to devalue; although this decision did not mean allowing the peso to float freely. Policymakers' preferences for a fixed exchange rate had several justifications. Firstly, Mexico had still to resolve the external debt question; secondly, only establishing a credible exchange rate peg could help discourage speculation; and thirdly, policymakers still believed that a stable exchange rate was essential to attract the flow of foreign capitals and foster foreign trade.[39]

Because it was impossible to return to the old parity in mid-1932 without a strong gold reserve, the Mexican government passed a series of reforms aimed at strengthening Banxico's ability and power to control the exchange rate. Table 3 offers an overview of the institutional changes to the central bank introduced between 1931 and 1933. For the argument of this paper, it is important to underline the fact that the vast majority of the central bank's new legislation had the goal of allowing it to manage and control its international reserves and defend the exchange peg. The monetary law of 1931 created a new gold fund for the exclusive purpose of preserving the

[38] In June 1930, Banxico's gold reserve amounted to US$ 8 million, and dropped to less than US$ 2 million by the end of July 1931. See Federal Reserve System, *Banking and Monetary Statistics* (1943, p. 550).

[39] See "Memorandum", 17 Feb 1933, AGM, Box 41, File 90; and "El control de los cambios", *Excélsior*, 3 Nov 1932.

exchange rate parity. Once some exchange restrictions were established, another decree, approved in September, prohibited the export of gold minted in the Republic, and empowered the Treasury to purchase gold at prevailing market rates. At the beginning of 1933, two additional decrees gave Banxico complete control over foreign exchange transactions.These reforms represented a major change with respect to the pre-1931 scenario, in which private banks –including both Mexican banks and the branches of foreign banks– competed with the central bank in accumulating gold and foreign exchange. The central bank's process of nationalization and centralization of the national monetary regime allowed Banxico extra room for manoeuvre. As the Mexican President Abelardo Rodriguez stated, a strong and more efficient central bank was essential to shield the national economy from the world monetary crisis; this made it "indispensable to take certain measures destined to protect the international value of currency against any fluctuations".[40] These measures, described as the first step towards re-joining the gold standard, were shortly followed by a new exchange rate strategy.[41]

In mid-1933, under the impetus of Miguel Palacio Macedo, a member of the board of directors appointed by Alberto Pani, Banxico officials discussed their longer-term strategy of how to ensure lasting exchange rate stability. Although the institutional reforms approved in 1932 and 1933 further strengthened the central bank's control over monetary and exchange rate policy, cooperation with the United States was essential to definitively stabilize the peso–dollar exchange rate. But as Palacio Macedo insisted, this would only be possible if they could persuade the US Federal Reserve Bank "to open direct lines of credit" in their favour.[42]

5. From isolation to the dollar bloc: the 1933-1936 years

The year 1933 represents the watershed for the interwar international monetary system. At that time, the division of the world into monetary blocs was informed by several factors, such as the dollar's devaluation in April 1933, the breakdown of the World Economic Conference held in London in June of that year, and the following unsuccessful attempts to reach international agreement on a common response to the 1931 crisis (Brown, 1940). Disagreements between the United States, United Kingdom and France regarding the new exchange rate policy stabilization provided a new opportunity for Mexico.

The groundwork for a new model of Mexican monetary cooperation was set on 12 April 1933, when Franklin Delano Roosevelt officially invited a Mexican delegation to the Washington Conference, a preparatory meeting for the London Conference. During the former, several US policymakers, concerned about the future of the gold standard, stated their willingness to support a "stabilization of exchange rates to allow a general equilibrium" between the two countries.[43]

Despite these positive statements, no plan was proposed. The lack of a bilateral agreement further worried Mexican diplomats, who did not trust Roosevelt's assurances. As representative of Mexico at the London World Economic Conference, Alberto Pani, in his speech on 16 June, declared that the Mexican future monetary policy needed to be flexible and open, in order to adapt "to any international system that the Conference recommended".[44] However, the notorious "Bombshell Message", in which President Roosevelt renounced the dollar's stabilization, changed the Mexican outlook.[45]

At the end of 1933, Banxico still aimed for a progressive return to the gold standard; but the international environment had changed dramatically since the conference in London. Alberto Pani confidentially confessed that the "deplorable conditions" resulting from Roosevelt's choice had directly caused the formation of separate monetary blocs.[46] The United Kingdom had already begun to establish and expand the sterling bloc by signing monetary treaties with Argentina and Denmark. In parallel, a "Little Entente" was being organized, grouping together France and other countries that still used the gold standard. Only the United States had not taken any formal action.[47] Talking to Brazilian and Cuban diplomats, Pani asserted that the only way to re-establish a stable exchange rate with the United States was to wait until the dollar reached a "permanent value".[48] In a letter addressed to the Mexican President Ortiz Rubio, Pani formalized his intention to postpone any final decision until the end of the Pan-American Conference, to be held in Montevideo. It would have been at this point that "surely the American government [would seek] to follow the example of Great Britain, creating a regional monetary system".[49] Waiting for this moment, in August 1933 the Secretary of the Treasury emphasized once more the importance of "synchroniz[ing] the exchange between peso and dollar to the level of 3.55" (i.e. 28.17 cents of US$ per Mexican peso).[50] In November 1933, the Mexican central bank set the goal of keeping a fixed exchange rate at US$ 27.7 cents.[51] Even when the dollar was devalued by about 40 % in relation to gold in January 1934, the peso remained pegged to the US currency.[52]

Clearly, the strength of the peso at the new rate was strictly dependent on any change in US foreign policy. During the Montevideo conference, the US showed hesitancy about the possibility of institutionalizing a regional exchange coordi-

[40] DO, 3 May 1933.

[41] "Se da el primer paso para que se restablezca el patrón oro", *Excélsior*, 23 Sep 1932.

[42] Acta N. 471, 28 Jun 1933, AHBM.

[43] "Pani to Calles", 11 Apr 1933, Archivo Calle Torreblanca, Fondo Plutarco Elias Calles. File 109, File 5/7.

[44] League of Nations, *Journal of The Monetary and Economic Conference*, No. 6, 16 Jun 1933, p. 38.

[45] "Report of Mr. Alberto J. Pani, and Chairman of the Delegation of Mexico to Mr. Antonio Castro Leal", 1933, Archivo de la Secretaria de Relaciones Exteriores (herafter ASRE) Series III-1185-2.

[46] "Background for action of Mexico and Washington talks related to Montevideo. Confidential Memorandum N.2", 29 Jun 1933, ASRE LE-245.

[47] "Seventh Pan American Conference held in Montevideo. Confidential Memorandum N.3", 30 Jun1933, ASRE LE-245.

[48] Ibid.

[49] "Background for action of Mexico and Washington talks related to Montevideo. Confidential Memorandum", 29 Jun 1933 ASRE LE-245.

[50] "Habla Alberto Pani", El Nacional Revolucionario, 17 Aug 1933.

[51] Acta N. 489, 9 Dec 1933 AHBNM.

[52] The gold value of the peso, after the dollar devaluation, had fallen to less than one-third of what it had been, and what it still was officially, according to the new monetary law of 1931.

nation mechanism.[53] Nevertheless, since the formalization of the sterling bloc at the Ottawa Conference of 1932, the general concern about UK's international monetary policy had led to a closer bilateral cooperation between Mexico and the US. This had two main features: first, it established stable institutional channels between the two countries' central banks. Since the middle of 1933, Banxico's board president Augustin Rodriguez had explored the possibility of establishing a formal relation with the FED. In April of the following year, Rodriguez explained his/Mexico's new exchange rate policy to the influential governor of the Federal Reserve Bank of New York (FRBNY), George Harrison. The main goal of the new policy, he said, was "to defend a fixed exchange rate between the peso and the dollar" by depositing a "certain amount of gold bars"[54] held in the FRBNY's vault. This would enable Banxico to defend the horizontality of the exchange rate "against the fluctuations which local speculation would tend to cause".[55] After performing standard checks of Banxico's statute and certifying the credibility of its proposal, the FED's board of directors agreed to cooperate by earmarking the Mexican gold in exchange for payment of a custody fee of one % per annum, and showed their willingness to cancel the gold embargo.[56]

The second feature of this cooperation concerned the US's new silver policy. At the beginning of 1934, the economy and the export sector were slowly recovering from the Great Depression slump. Export recuperation increased the supply of foreign exchange, but this improvement was not enough to create a solid gold reserve. Aiming to achieve this, Mexico quickly took advantage of Roosevelt's silver policy. Given that the silver price rose from US$ 35.1 cents per fine ounce in June 1933 to a maximum of US$ 74.9 in May 1935, Banxico could potentially strengthen its reserve position by selling silver in exchange for gold. As Figure 4 shows, the gold reserves climbed from US$ 25 to US$ 45 million from March 1934 to January 1936.[57] The profits on revalued central bank reserves were allocated in part to the specific gold fund designated for the sole purpose of defending the fixed exchange rate, while another portion was transferred directly to the fiscal authorities (Pani, 1935, p. 60). The rising price of silver also caused some distress to the Mexican monetary system. Towards the end of April 1935, the price of silver rose to US$ 72 cents per ounce and pushed the peso up to the point where it became profitable to melt it down and sell it for bullion. Immediately, the Mexican Congress issued a decree and ordered the surrender of all the silver coins to the central bank in exchange for banknotes, which would be issued against the reserve so far accumulated. Despite a two-week suspension of convertibility, the decree limited the emission of new banknotes to a maximum of double the amount of the silver monetary reserve.[58]

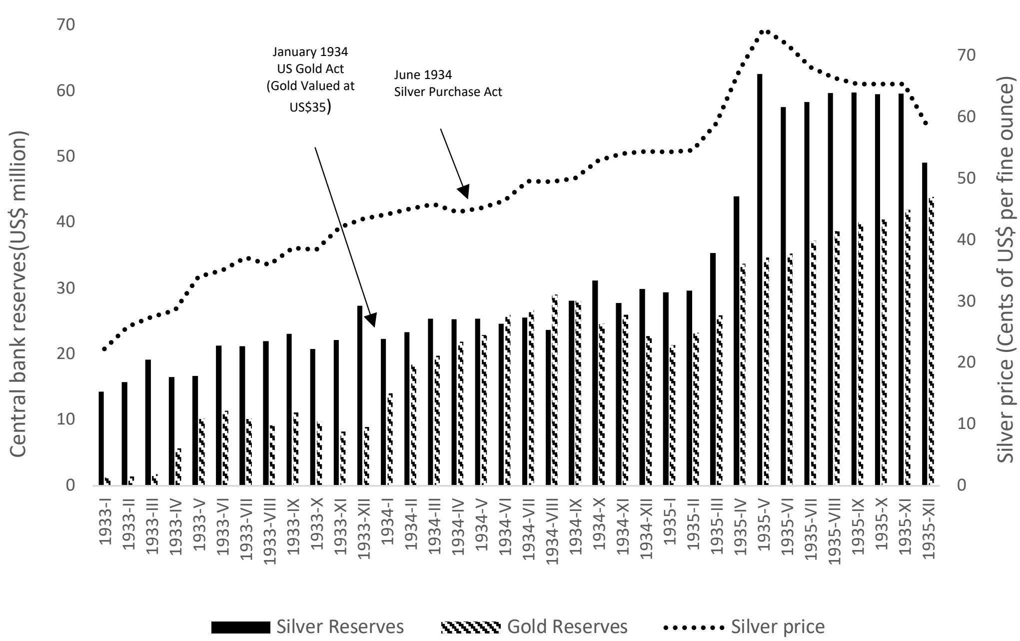

Figure 4. Gold and silver central bank reserves and evolution of the silver price (gold valued at US$ 20.67 per fine ounce through January 1934 and at US$ 35 thereafter).

Sources: The silver and gold reserves are taken from Banxico, *Informes Annuales*, and Board of Governors of the Federal Reserve System, *Banking and Monetary Statistics* (1943) pp. 544-557. For the silver prices, see Dickson Leavens, *Silver Money* (Bloomington: Principia Press, 1939), pp. 356-357.

[53] Spruille Braden, the American delegate, confirmed Roosevelt's will to give priority to domestic economic issues with respect to an international stabilization. See "Seventh International Pan-American Conference held in Montevideo, Uruguay, from 3 to 26 December 1933", 29 Jun 1933, ASRE LE-235.

[54] "Augustin Rodriguez to George Harrison", 9 Apr 1934, AFRB.

[55] Id.

[56] "Deputy Governor Crane to Augustin Rodriguez", 20 Apr 1934, Foreign Information Division: Bank of Mexico, AFRB.

[57] "Mexican conference with Henry Morgenthau Jr. and Franklin Delano Roosevelt", Henry Morgenthau Junior Diaries (hereafter HMD), 29 Apr 1935.

[58] DO, 27 Apr 1935.

The crisis of late April 1935 emphasized, once more, the reasons for the choice of a fixed exchange rate. Due to the rise of the peso's market value, Banxico was faced with large losses if pesos continued to be sold at US$ 27.7 cents, given that they were in fact worth more if sold at the price of the metal. By April 1935, the Bank of Mexico abruptly left the market, leaving the peso to suddenly climb to the rate of 27.9 to the dollar.[59] Once again, policymakers did not consider the option of allowing the exchange rate to float, and a few days later, the Bank of Mexico re-entered the market to defend the exchange rate.[60] It justified its preference for a fixed exchange rate by invoking the consequence of a free float for the national financial and economic system. As a *New York Times* correspondent observed on Monday, 29 April, Banxico's decision to stop supporting the peso "reproduced in miniature the New York crash of 1929 in Francisco I Madero street", where "in every broker's office hatless men with blazing eyes sold and bought, bought and sold, hoping by some miracle to guess correctly what was going on in Mexican central bankers' heads".[61] Furthermore, national businessmen's reaction was frantic. "The bulk of Mexican industry and the whole financial and business structure", they complained to Banxico's officials, "are linked directly to the dollar, and therefore extraordinarily sensitive to every possible shift of the peso-dollar ratio".[62] Fears of speculative attacks, combined with its desire to foster the development of robust trade relations, pushed Banxico officials to defend the parity with the dollar. According to them, the "magic ratio of 27.7" would lead to financial, industrial and commercial prosperity unseen since before the Mexican Revolution of 1910.[63]

The silver crisis not only tested the credibility of the Mexican central bank; it also strengthened cooperation and coordination with the United States' monetary authorities. In this case, it was not the Mexican but the United States government that revealed the boundaries of cooperation. Harry Dexter White –the US Treasury Department official who went on to be the most influential representative at the Bretton Woods Conference– elaborated the new international guidelines of US international economic policy. In a missive sent to the US Secretary of the Treasury, Henry Morgenthau, White highlighted the necessity of "returning to a currency exchange, and trade relationship that more closely approximates as the world set up that prevailed before the 1929 crisis".[64] The selected field for White's new policy experiment was Latin America. Morgenthau seconded this vision. The Secretary of the Treasury, somewhat wary about the creation of a sterling bloc, suggested to the US president that an "American dollar bloc" be formed with all South American countries, apart from Brazil and Argentina ("who are feeling at the present unfriendly toward us"), and China.[65]

It goes without saying that this return to the 1920s –as White suggested– was problematic, given how ineffective the gold standard had proven to be during the crisis. A new stabilization and cooperation scheme, different from the old gold standard, was therefore sketched out in March 1935.[66] Following a critical review by both Morgenthau and the Mexican Secretary of the Treasury Eduardo Suarez, the new plan was presented at the beginning of the following January.[67] Once FED's officials had demonstrated their willingness to share their organizational know-how with their Mexican counterparts, Morgenthau introduced the possibility of offering an emergency loan to Mexico, with the sole goal of defending the peso whilst it was pegged to the dollar. This operation, implemented via the Exchange Stabilization Fund, entitled a maximum loan of US$ 5 million, with the only guarantee being an equivalent amount of silver pesos as collateral.[68] Even though Mexico agreed to pay a 3 % interest rate on the peso account, this short-term currency swap could be renewed on a monthly basis. As such, it functioned as an insurance policy against economic misalignment that would otherwise jeopardize the fixity of the exchange rate.[69] Mexican policymakers accepted the offer. After struggling since 1931 to rebuild a gold fund, the opportunity to access a new *ad hoc* solution to smooth exogenous shock eased Banxico's work. The central bank continued to accumulate its gold reserve to enhance its ability to provide credit accommodation in case of another crisis, but without the urgency that had characterized its interventions in the previous years.

6. Conclusion

What drove the Mexican exchange rate regime choice from 1925 to 1936? This article has attempted to answer this question by considering when, how, and why policymakers changed their exchange rate policy during the interwar years. I reach the conclusion that during the entire period under scrutiny, Mexican officials exhibited a stronger preference for a fixed exchange rate regime. Reasons for this "fear of floating" lay in the belief that it would be impossible to control speculation, avoid inflation, and have a normal trade relationship with Mexico's main economic partner, the United States, without a strong nominal anchor. Some of these convictions were dictated by real problems the country experienced during those years. The financial fragility caused by the underdevelopment of the national monetary and banking system fostered waves of speculation that were impossible to tackle without a pegged exchange rate regime. Other, more ideological preoccupations,

[59] Acta N. 571, 30 Apr 1935, AHBM.

[60] Id.

[61] "A silver country minus silver coin: Mexico's new monetary policy", *New York Times*, 2 Jun 1935.

[62] Acta N. 574, 22 May 1935, AHBM.

[63] Id.

[64] "Recovery Program: The International Monetary Aspect", 15 Mar 1935, Harry Dexter White Papers, Box 3 Folder 13.

[65] "Morgenthau to Roosevelt", 15 Apr 1935, HMD.

[66] By the middle of 1935, Morgenthau communicated to Banxico boards that the new US policy was to sell "all the gold you want". "Mexican conference with Henry Morgenthau Jr. and Franklin Delano Roosevelt", 29 Apr 1935, HMD.

[67] According to some scholars, the Mexican–US arrangement of 1936 featured some elements which prefigured the post-1945 IMF scheme. See, for example, Bordo and Schwartz (2001). Nevertheless, starting in 1934, new plans for the organization of a new international monetary system regime also emerged in Europe. See Ljungberg and Ögren (2022).

[68] "Draft of Letter from Federal Reserve bank of New York to Banco de Mexico. N. 1", 1 Jan 1936, HMD. The Exchange Stabilization Fund (ESF) was established by the Gold Reserve Act of 31 Jan 1934. See also Anna Schwartz (1997).

[69] "Draft of a letter from Federal Reserve Bank of New York to Banco de Mexico", 2 Jun 1936, HMD.

such as the fear of inflation, were the result of deeply rooted beliefs that dated back to revolutionary years.

These findings challenge the conventional view that describes the Great Depression as a turning point in policymakers' mindset regarding the exchange rate regime choice. As shown, characterizing the Mexican exchange rate regime and how it changed over time is not an easy task. The classification methodology used in the first part of the paper underscores how, in the period under analysis, there was a large gap between the monetary authority's policy goals and the effective moves that the exchange rate experienced. Between 1925 and 1931, monetary chaos and the economic crisis resulting from the Great Depression hampered every attempt to stabilize the peso. Instead of being controlled by the central bank, the vast majority of gold circulated amongst the public or was hoarded in the vaults of private banks. The monetary law of July 1931 represented an attempt to correct these problems and defend the gold standard regime. However, although a steep depreciation of the currency followed, it was not the result of a deliberate policy of the government or central bank to pursue a competitive devaluation; rather, it should be attributed to the fundamental structural problems in the banking system. The opportunity to abandon exchange rate targeting and to adopt an independent monetary policy was not seized. Once its reserves were exhausted, a series of laws and decrees gave Banxico complete control over gold and foreign exchange transactions. Reintroducing a peg between the peso and the dollar was made possible thanks to Roosevelt's silver policy and the reinforcement of monetary cooperation with the United States. This cooperation manifested itself in various forms. A first period of information and monetary technique-sharing between the Mexican and US central banks was followed by the US offering an *ad hoc* lending facility to Mexico, for the sole purpose of defending the fixity of the exchange rate. Thus, domestic reforms in Mexico and the US government's accommodating attitude to the country together enabled Banxico's role as defender of the fixed exchange rate.

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